DIVISION OF CONSUMER ADVOCACY
Department of Commerce and
Consumer Affairs
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Honolulu, Hawaii 96813
Telephone: (808) 586-2800

FILED
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PUBLIC UTILITIES COMMISSION

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

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| In the Matter of the Application of<br><br>PARADISE MERGERSUB, INC., GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC., AND VERIZON SELECT SERVICES INC.<br><br>For approval of a merger transaction and related matters. | DOCKET NO. 04-0140 |

**DIVISION OF CONSUMER ADVOCACY'S**
**FIRST AND SECOND SUBMISSION OF INFORMATION REQUESTS**

Pursuant to the agreed upon procedural schedule set forth in the Stipulated Procedural Order which was submitted for the Commission's review and approval on August 23, 2004, the Division of Consumer Advocacy hereby submits its **FIRST AND SECOND SUBMISSION OF INFORMATION REQUESTS** in the above docketed matter which was informally filed with Applicant on July 27, 2004 and August 3, 2004.

DATED: Honolulu, Hawaii, August 26, 2004.

Respectfully submitted,

By John E. Cole
JOHN E. COLE
Executive Director

DIVISION OF CONSUMER ADVOCACY

## DOCKET NO. 04-0140

## PARADISE MERGERSUB, INC., GTE CORPORATION VERIZON HAWAII INC., AND VERIZON SELECT SERVICES INC. FOR APPROVAL OF A MERGER AND RELATED TRANSACTIONS

## FIRST SUBMISSION OF INFORMATION REQUESTS

## INSTRUCTIONS

In order to expedite and facilitate the Consumer Advocate's review and analysis in the above matter, the following is requested:

1. For each response, the Company should identify the person who is responsible for preparing the response as well as the witness who will be responsible for sponsoring the response should there be an evidentiary hearing;
2. Unless otherwise specifically requested, for applicable schedules or workpapers, the Company should provide hard copies of each schedule or workpaper together with one copy of each such schedule or workpaper on electronic media in a mutually agreeable format (e.g., Excel and Quattro Pro, to name two examples); and
3. When an information request makes reference to specific documentation used by the Company to support its response, it is not intended that the response be limited to just the specific document referenced in the request. The response should include any non-privileged memoranda, internal or external studies, assumptions, Company instructions, or any other relevant authoritative source which the Company used.
4. Should the Company claim that any information is not discoverable for any reason:

b. State all facts and reasons supporting each claimed privilege and objection;

c. State under what conditions the Company is willing to permit disclosure to the Consumer Advocate (e.g., protective agreement, review at business offices, etc.); and

d. If the Company claims that a written document or electronic file is not discoverable, besides complying with subparagraphs 4(a-c), identify each document or electronic file, or portions thereof, that the Company claims are privileged or will not be disclosed, including the title or subject matter, the date, the author(s) and the addressee(s).

**DOCKET NO. 04-0140**

**PARADISE MERGERSUB, INC., GTE CORPORATION, VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC. AND VERIZON SELECT SERVICES INC. FOR APPROVAL OF A MERGER AND RELATED TRANSACTIONS**

**SECOND SUBMISSION OF INFORMATION REQUESTS**

**INSTRUCTIONS**

In order to expedite and facilitate the Consumer Advocate's review and analysis in the above matter, the following is requested:

1. For each response, the Company should identify the person who is responsible for preparing the response as well as the witness who will be responsible for sponsoring the response should there be an evidentiary hearing;
2. Unless otherwise specifically requested, for applicable schedules or workpapers, the Company should provide hard copies of each schedule or workpaper together with one copy of each such schedule or workpaper on electronic media in a mutually agreeable format (e.g., Excel and Quattro Pro, to name two examples); and
3. When an information request makes reference to specific documentation used by the Company to support its response, it is not intended that the response be limited to just the specific document referenced in the request. The response should include any non-privileged memoranda, internal or external studies, assumptions, Company instructions, or any other relevant authoritative source which the Company used.
4. Should the Company claim that any information is not discoverable for any reason:

a. State all claimed privileges and objections to disclosure;

b. State all facts and reasons supporting each claimed privilege and objection;

c. State under what conditions the Company is willing to permit disclosure to the Consumer Advocate (e.g., protective agreement, review at business offices, etc.); and

d. If the Company claims that a written document or electronic file is not discoverable, besides complying with subparagraphs 4(a-c), identify each document or electronic file, or portions thereof, that the Company claims are privileged or will not be disclosed, including the title or subject matter, the date, the author(s) and the addressee(s).

**DOCKET NO. 04-0140**

**PARADISE MERGERSUB, INC., GTE CORPORATION VERIZON HAWAII INC., AND VERIZON SELECT SERVICES INC. FOR APPROVAL OF A MERGER AND RELATED TRANSACTIONS**

**FIRST SUBMISSION OF INFORMATION REQUESTS**

CA-IR-1 **Ref: Application, Exhibit 2 Organization and Identity of Buyer.**

For each of the entities set forth in the organization table exhibit above "Paradise MergerSub, Inc.", please provide the following information:

a. Complete copies of draft or final LLC agreements, partnership agreements, articles of incorporation, and by-laws documentation.

b. For each entity where the information requested in part (a) does not exist, a statement of the date when such information is expected to become available.

c. Identify each individual or entity with or expected to have an economic interest of 10 percent or greater, indicating the approximate percentages associated with each such interest.

d. Identify the current directors, general partners and officers of each non-Verizon entity set forth in Exhibit 2 and any other individuals expected to have post-closing voting or control interests and describe their affiliation with each economic interest identified in part (c), if any.

e. Explain the extent to which any entity or individual identified in response to parts (c) and (d), above, are expected to serve as an employee, contractor, Board/LLC member or engage in any other post-closing transactions with the surviving Paradise MergeSub, Inc.

CA-IR-2 **<u>Ref: Application, pages 14 through 16, Willingness and Ability.</u>**

Please identify and describe each local exchange telephone company investment previously made by Carlyle entities, indicating how experience gained with such holdings will impact the ability of Carlyle to effectively manage its proposed investment in Hawaii.

CA-IR-3 **<u>Ref: Application, pages 14 through 16, Willingness and Ability.</u>**

Please provide a list of each investment Carlyle has made over the past five years and the (actual or projected) holding period for each investment. (Note: the company name is not necessary, simply identify the type of investment: i.e., telecom, defense, etc.)

CA-IR-4 **<u>Ref: Application, pages 14 through 16, Willingness and Ability.</u>**

The Carlyle Group has recently received some negative publicity regarding some of its defense-related investments. Does the Company have a plan to address that image issue publicly with telephone consumers in Hawaii? If so, how; if not why not?

CA-IR-5 **<u>Ref: Application, page 16, Section D3(a) Ability.</u>**

Please explain the post-ownership management responsibilities expected to be assumed by <u>each</u> of Messrs. Attwood, Kennard and Akerson and state the approximate average number of hours per month each is expected to dedicate on a continuing basis to the Hawaii acquired businesses and the portion of such hours expected to be spent on-site in Hawaii.

CA-IR-6 **<u>Ref: Application, pages 14 through 16, Willingness and Ability.</u>**

Please describe each instance the Applicants are aware of in which a private equity investor has completed a leveraged buyout of a large incumbent local exchange telephone company ("ILEC") and provide copies of regulatory orders issued to approve such transactions, as available.

CA-IR-7 **<u>Ref: Application, pages 14 through 16, Willingness and Ability.</u>**

Please explain the anticipated holding period and exit strategy (IPO, strategic sale, etc.) alternatives being considered by Buyer with respect to the subject Verizon Hawaii business and assets and state each reason why the proposed leveraged buyout of the business by potentially limited-term owners is thought to be consistent with the public interest.

CA-IR-8 **<u>Ref: Application, pages 14 through 16, Willingness and Ability.</u>**

Please explain whether a public offering of common stock in Carlyle's Hawaii LEC would be the most likely manner in which Carlyle would liquidate its holdings in the company.

CA-IR-9 **<u>Ref: Application, page 15, Section D2 Willingness.</u>**

Please provide complete copies of the consulting and other service agreements between Buyer and each of the following entities retained because of, "...the importance of ensuring a seamless transition for customers...":

a. Deloitte and Touche LLP

b. David Torline

c. The selected "back office service provider"

CA-IR-10 **<u>Ref: Application, page 15, Section D2 Willingness.</u>**

Please provide complete copies of the reports, analyses, studies, projections, proposals, specifications and other work product produced by each of the following entities in connection with their work for the Buyer:

a. Deloitte and Touche LLP.

b. David Torline.

c. The selected "back office service provider."

CA-IR-11 **<u>Ref: Application, page 12, Public Interest.</u>**

Please state <u>each</u> reason why the proposed transaction is believed to be in the public interest, indicating and quantifying each tangible benefit to the public that is created or enabled by Carlyle acquisition. Provide complete copies of all calculations and supporting documentation associated with each element of your response.

CA-IR-12 **<u>Ref: Application, page 12, Public Interest.</u>**

a. Do the Applicants believe that approval and closing of the proposed transaction will create incremental operational savings, new revenue opportunities or other economic benefits, relative to continued Verizon ownership of the subject businesses?

b. If affirmative, please individually state each such savings, new revenue source or other economic benefit created by the transaction, and provide all available information to quantify same.

CA-IR-13 **<u>Ref: Application, page 16, "locally based management and investors."</u>**

Please state and describe all known details regarding the Buyer's "Local investors" and explain the degree of autonomy and control intended for such local investors, in contrast with the voting rights, consent rights and other governance controls to be reserved for the Carlyle interests.

CA-IR-14 **<u>Ref: Application, page 3, "Certificates of Authority."</u>**

Please provide complete copies of all existing COA's associated with the Verizon Hawaii businesses and assets that are referenced, as well as the forms of such new COA's that are requested.

CA-IR-15 **<u>Ref: Application, page 4, "The guarantee" and "The pledging."</u>**

Please provide complete copies of the formal documents explaining the terms of the requested debt guarantees and pledge, or explain when such documents will become available.

CA-IR-16 **<u>Ref: Application, Exhibit 1 at 2.7(b) "Base Purchase Price."</u>**

Please identify each financial advisor employed by Buyer and Seller in connection with the subject transaction and provide the following information:

a. Provide complete copies of all engagement letters, contracts and other documentation associated with services provided.

b. Provide a listing of all correspondence, reports, presentations, analyses, studies, offering memoranda, presentation graphics and other documents that were produced by each advisor.

c. Provide a complete copy of the Verizon Information Summary document dated September 2003.

d. Provide a complete copy of the Verizon Project Paradise Management Presentation dated December 2003.

e. Provide a complete copy of preliminary and subsequent Carlyle investment review committee memoranda, reports, financial projections and supporting documentation associated with the Buyer's internal assessment of the subject investment.

f. Provide complete copies of all other valuation reports/analyses that were received by each of the parties and relied upon to determine a reasonable range of purchase prices for the Verizon Hawaii business, assets and operations.

CA-IR-17 **Ref: Application, Exhibit 1 at 2.7(b) "Base Purchase Price."**

Please provide complete copies of all spreadsheet models and other calculations employed by Buyer to evaluate the financial performance of the subject Hawaii business and assets under new ownership (magnetic media and hard copy). Include with your response complete electronic and hard copies of all upstream revenue, cost, staffing studies, bid solicitations, consulting reports and other analyses used to derive input values for the model (referenced to the input cell addresses in the primary model) as well as the calculations performed to reformat the final projection results as reflected in Exhibit 6.

CA-IR-18 **<u>Ref: Application, Exhibit 5.</u>**

Please provide complete electronic and hard copies of all financial projections supplied by Carlyle entities to providers of debt financing for the subject transaction, to the extent such projections were different in any respect from materials supplied in response to CA-IR-9, above.

CA-IR-19 **<u>Ref: Application, Exhibit 6.</u>**

Please provide complete electronic and hard copies of all financial projection sensitivity runs prepared by or for the Buyer to evaluate <u>alternative assumptions</u> regarding future operations and financial performance of the acquired business and assets, indicating how each sensitivity analysis performed by or for the Buyer reflects changed assumptions from Exhibit 6.

CA-IR-20 **<u>Ref: Application, Exhibit 6.</u>**

Please confirm that all free cash flows within the Buyer's financial projections are assumed to be used to repay debt, rather than providing any dividends to equity investors, and describe each anticipated actual constraint upon dividends to equity investors under anticipated debt restrictions or other financial covenants.

CA-IR-21 **<u>Ref: Application, Exhibit 6.</u>**

a. What does Carlyle consider to be an acceptable hurdle rate for a transaction of this type and how is that hurdle rate calculated?

b. If the hurdle rate is calculated as pre-tax cash flow compared to cash investment, please explain how that return is realized if scheduled interest payments are met.

c. Moreover, if scheduled interest payments are met, as set out in Exhibit 6 to the Application filed June 21, 2004 in Docket No. 04-0140, please explain how Carlyle's investors are able to achieve the return they require.

CA-IR-22 **<u>Ref: Application, Exhibit 6.</u>**

Please provide the most detailed available comparison of historical revenue, operating expense and profit margin levels achieved under Verizon ownership of the Hawaii business and assets, relative to the projected levels of revenues, expenses and profit margins anticipated under Carlyle ownership prospectively. Explain each operational change planned by the Buyer that is expected to yield improved margins prospectively.

CA-IR-23 **<u>Ref: Application, page 16, "locally based management and investors."</u>**

Please provide a complete copy of the prospectus presented to local Hawaii investors describing the planned purchase of Verizon Hawaii by Carlyle. Please also provide all statistical and financial data made available to those investors.

CA-IR-24 **<u>Ref: Application, Exhibit 5</u>**

According to documents filed in Exhibit 5 to the Application filed June 21, 2004 in Docket No. 04-0140, the banks that expect to lend money to Carlyle to fund the purchase of Verizon Hawaii require that Carlyle obtain a bond rating from Moody's and Standard and Poor's [Exhibit A, Conditions Precedent to Initial Borrowing (1), p. 10].

a. Please provide a complete copy of all documents presented to the rating agencies by The Carlyle Group with regard to obtaining a bond rating for the new entity.

b. Also please provide the resultant rating rationale provided by S&P and Moody's.

CA-IR-25 **<u>Ref: Application, Exhibit 5</u>**

The Company has indicated and its bankers expect that the new entity, with an equity ratio of less than 20%, will have a below investment-grade bond rating. Please explain why—absent any rate decrease—it is beneficial for Hawaii telephone customers, who currently receive service from an investment-grade corporation, to have that entity changed to a corporation with substantially more financial risk.

CA-IR-26 **Ref: Application, Exhibit 5.**

At pages 9 and 10 of Exhibit 5 to the Application filed June 21, 2004 in Docket No. 04-0140, the Company's Lenders request that Carlyle provide a balance sheet, income statement, shareholder's equity and cash flow statements for the past three years as well as monthly operating reports containing data with regard to the number of access lines for the company. Please provide copies of that information requested by the Lenders.

CA-IR-27 **Ref: Application, Exhibit 6.**

In discussions with Consumer Advocate representatives, the Company indicated that its assumed interest rates for its debt (6.25% and 6.50%) was higher than indicated by current rates and was, effectively, considered to be a hedge rate that could be assumed to apply to the 10-year period.

a. Please provide supporting documentation for these cost rates.

b. Has the Company run its financial forecast using current LIBOR projections and the corresponding required premiums (225 and 220 basis points)?

c. If so, please provide electronic copies of those projections; if not, please explain why not.

CA-IR-28 **<u>Ref: Application, Exhibit 5.</u>**

Please define the term "high yield road show," as used in Exhibit B (p. B-6) attached to Exhibit 5 to the Application filed June 21, 2004 in Docket No. 04-0140.

CA-IR-29 **<u>Ref: Application, Exhibit 5.</u>**

Please provide available evidence from recent similar mergers or buy outs that support the Company's apparent view that the financial arrangements underpinning the deal, i.e., leverage ratio, junk bond rating, unsecured term loans with interest rates approximating 10%, cash-on-cash rate of return, are "normal for this type of transaction" with respect to public utility operations.

CA-IR-30 **<u>Ref: Application, Exhibit 5, "Exhibit A" pages 13-14.</u>**

Please confirm that the maximum debt leverage acceptable to the Lenders providing debt financing is limited to a ratio of total balance sheet debt to adjusted EBITDA or no greater than 5.75 to 1.00 or explain any alternative ratios and calculations defining maximum debt leverage. Provide an illustrative calculation of the applicable ratio at closing, using the calculations and methods described throughout paragraph (11) of this covenant.

CA-IR-31 **<u>Ref: Application, Exhibit 5, "Exhibit A" page 17.</u>**

Please provide a complete copy of the "Deloitte & Touche Report dated February 27, 2004", as referenced under "Financial Covenants".

CA-IR-32 **<u>Ref: Application, Exhibit 1 "Agreement of Merger" Referenced Documentation</u>**

Please provide complete copies of all Seller and Buyer Disclosure Schedules, Annexes, Equity and Debt Commitment Letters, Fee Letters and other documents referenced in the Agreement of Merger that were not included with the Exhibits filed on June 21.

CA-IR-33 **<u>Ref: Application at page 19, 4(a) "Rates."</u>**

Please confirm that Buyer and MergerSub have proposed no enforceable commitment to <u>not</u> seek increased rates from the Commission subsequent to closing of the proposed transaction. Alternatively, if any specific regulatory or pricing plan is contemplated, please state each element of such plan.

CA-IR-34 **<u>Ref: Application at page 20, 4(d) "Transaction and Transition Costs."</u>**

Please provide a detailed itemization of actual to-date and anticipated transaction and transition expenses incurred by each party (Carlyle entities and Verizon entities) and respond to the following:

a. Describe amounts incurred by payee and the purpose of the activities of and expenditures to each payee.

b. Identify which of these costs will be reflected within the adjusted purchase price used to calculate acquisition goodwill or gain/loss?

c. Identify any of these costs that will be deferred or capitalized on Verizon Hawaii books for recovery in future rate case test periods?

CA-IR-35 **<u>Ref: Application at page 18, 3(d) "Transition Planning."</u>**

Please explain the status of transition planning and provide a complete copy of the most detailed available documentation of Transition Planning Team organization, the major identified tasks for each Team, known plans to address transition issues, transition timelines/dates and describe each transition issue decision that has been finalized to-date.

CA-IR-36 **<u>Ref: Application at page 18, 3(d) "Transition Planning."</u>**

Please provide a detailed listing and analysis of <u>each</u> type of mainland support service for Hawaii operations that is presently provided by Verizon entities and quantify the related costs for each of the past 2 years and explain the following:

a. Which of the listed services are linked to core operations that will continue to be required if the proposed transaction is closed?

b. Which of the listed types of services would no longer be required by the Hawaii Telco after acquisition?

c. Which of the listed types of services are expected to be performed directly by Hawaii Telco using internal resources or local contractors?

d. Which of the listed types of services are expected to be performed by entities associated with or controlled by the Buyer?

e. Which of the listed types of services are to be provisioned through the transition services agreement with Verizon at Exhibit C and for what period of time?

f. What approximate annual amount of additional cost or cost savings is anticipated during and after any transition period for <u>each</u> of the listed types of services now provisioned by Verizon mainland affiliates?

CA-IR-37 **Ref: Application at page 18, 3(d) "Transition Planning.**

a. Please explain the Buyer's plans for replicating the back office automated systems (hardware and software) currently employed by Verizon Hawaii and explain how each individually significant system will be transferred, terminated, modified or replaced upon closing of the acquisition by Buyer.

b. What are the anticipated one-time and ongoing annual costs associated with each planned change and how do such costs compare to Verizon Hawaii's actual costs for each system incurred in 2002 and 2003?

c. Provide summaries of any bid solicitations, proposals, consulting reports and other documents associated with your response.

CA-IR-38 **Ref: Application at page 18, 3(d) "Transition Planning.**

a. Does Carlyle believe it will be able to undertake back-office functions now currently handled on the mainland by Verizon, move them to Hawaii and operate them less expensively on an on-going basis?

b. If so, please explain why and provide any supporting evidence that such will be the case; if not please explain why not.

CA-IR-39

**Ref: Application at pages 25 to 27, Section G. "Approval of Transactions Related to Financing."**

Please provide a schedule stating the amounts of Verizon financing that is presently secured by any guarantee, security interest or mortgage of public utility property owned by Verizon Hawaii and compare this value to the proposed amounts of acquisition debt to be secured in such manner.

CA-IR-40

**Ref: Application at pages 25 to 27, Section G. "Approval of Transactions Related to Financing."**

Please provide the best available estimated quantification of Verizon Hawaii's exposure to uninsured casualty losses in the event of catastrophic hurricane or other natural disaster events and explain how Buyer's proposed insurance coverages will increase or reduce such exposure.

CA-IR-41

**Ref: Application Section D.1. Financial Fitness.**

Please describe and itemize the financial resources controlled by the Buyer for purposes of acquiring and operating the Verizon Hawaii business and subject assets and explain the following:

a. Ability of Paradise MergerSub, Inc. to receive future additional equity investment capital if needed to fund unanticipated construction requirements or recovery from uninsured casualty losses.

b. Amounts of undrawn line of credit loans for use by Paradise MergerSub, Inc. to receive additional working capital if needed to fund unanticipated construction requirements or recovery from uninsured casualty losses.

c. Other financial resources that would be available to Paradise MergerSub, Inc. to receive additional capital if needed to fund unanticipated construction requirements, sustained business declines or recovery from uninsured casualty losses.

CA-IR-42 **Ref: Application at pages 25 to 27, Section G. "Approval of Transactions Related to Financing."**

Please compare and quantify the access to new capital presently available to Verizon Hawaii under existing financing arrangements and covenants in contrast to the Buyer's anticipated access to new incremental committed capital that is projected to be available after closing under proposed debt covenants and the financial results anticipated in each future year projected within Exhibit 6.

CA-IR-43 **Ref: Application at pages 25 to 27, Section G. "Approval of Transactions Related to Financing" and Exhibit 6.**

Please describe the provisions within the Term Sheets in Exhibit 5 that serve to limit the total amount of debt capital available to fund the acquisition and the business subsequent to closing and also provide a calculation of the available but undrawn additional debt capital available to Carlyle in each year of the financial projections in Exhibit 6, through application of such provisions.

CA-IR-44

**<u>Ref: Application at pages 27 and 28, "Order Regarding Decision and Order No. 17377."</u>**

Please state and explain <u>each</u> reason why the previously ordered tracking and reporting of "...all merger related expenses, savings, and revenue enhancements attributable to regulated Hawaii services..." should no longer be reported to the Commission for the newly proposed transaction, given that such data was important in the consideration and approval of the previous change in ownership of the Company.

CA-IR-45

**<u>Ref: Exhibit 1 at 4.8(b) "Investigation."</u>**

Please provide a complete listing of the contents of the Data Room made available to Buyer for the conduct of due diligence investigation and provide copies of the indicated (listed) documents from that room, to the extent not voluminous (otherwise provide access to voluminous individual items).

CA-IR-46

**<u>Ref: Exhibit 1 at 2.7(b) "Merger Consideration."</u>**

Please provide a detailed calculation of the gain on sale anticipated to be realized by Verizon upon closing the subject transaction, indicating the book basis and tax basis of each group of assets (directory, long distance, Verizon Hawaii stock, etc.) and the estimated after tax gain for each such group. State all assumptions made in preparing such estimates and the basis for such assumptions.

CA-IR-47 Please explain whether Carlyle has any plans or has taken any actions to pursue Hawaii business investments beyond the subject transaction, indicating whether any potential additional investments would share any management, personnel or other resources with the acquired telephone business prospectively. Provide complete copies of any documents associated with your response.

CA-IR-48 Please provide a statement and summary of each service quality measure that was tracked in the normal course of business by Verizon Hawaii for each of the past three calendar years and for year-to-date 2004 and explain Verizon's service objectives and actual historical performance relative to each of such measures.

CA-IR-49 Please identify and describe each of the service quality measures that Carlyle intends to track for the Hawaii telephone company business post-closing, state the service objectives that are to be adopted and explain any changes in operations that would be implemented to maintain or improve upon service performance, indicating the timing and cost impacts of each such change.

CA-IR-50 **Ref: Application, Exhibit 1, Article VIII "Employee Matters."**

Please provide complete copies of all information provided to Verizon Hawaii employees to date to explain the impact of the proposed transaction upon their continued employment, wages and benefits.

CA-IR-51 **Ref: Application, Exhibit 1, Article VIII "Employee Matters" and Exhibit 6 Projections.**

a. Please provide the most detailed available assessment of staffing levels prepared by or for the Buyer and used to determine all planned changes in staff count by department and classification of employee, as reflected in the financial projections.

b. In addition, provide supporting documentation for each assumed loaded payroll cost, severance, training, relocation and other labor-related input value associated with changing staff levels.

CA-IR-52 **<u>Ref: Application Exhibit 1, Article VII "Employees and Employee Matters."</u>**

Please list all existing benefit plans available to Hawaii employees and explain the Buyer's plans for replacement, assumption or continuation of <u>each</u> existing Verizon Hawaii benefit plan, indicating the approximate annual cost incurred by Verizon Hawaii in 2003 for each plan and the anticipated annual cost to the Company under new ownership, to the extent determinable. Please organize your response in the format of Seller's Disclosure Schedule Section 3.14(a).

CA-IR-53 Please explain the efforts of Buyer to evaluate employee wage and benefit packages under Verizon ownership and to design new wage/benefit packages at parity to current arrangements. Describe each known change in existing Verizon wage/benefit plans and explain how/if Buyer's new compensation packages and the component costs of projected compensation are translated into the loaded labor cost rates reflected within Exhibit 6. Provide copies of documentation and calculations associated with your response.

CA-IR-54 Please explain all efforts of Buyer to evaluate Hawaii staffing levels relative to business requirements, transferred employees, services not acquired that Verizon provisioned with mainland affiliate resources, and planned back-office outsourcing arrangements.

Provide complete copies of all studies, reports, analyses, projections, workpapers and other documents associated with work in this area and results includable in Exhibit 6 financial projections.

CA-IR-55

**Ref: Application Exhibit 1, Sections 3.18 and 5.9 "Affiliate Contracts."**

Please confirm that all existing Verizon affiliate contracts, as listed in Seller's Disclosure Schedule Section 3.18. are to be terminated under the Agreement of Merger, except for those contracts listed in Section 5.9(e) and identify each new affiliate contract that will be initiated post-closing to govern the obligations and transactions between the regulated telephone company and the various AssetCo operations such as directory publishing, long distance and internet service operations.

CA-IR-56

**Ref: Application Exhibit 1, Sections 3.18 and 5.9 "Affiliate Contracts."**

Please provide a complete copy of all Publishing Agreement(s) that have been effective between Verizon Hawaii and affiliated companies since January 1, 1999, as well as all correspondence between Verizon and HPUC regarding same, and provide a copy of the comparable publishing agreement that is intended to be made effective between the telephone company and the directory publishing entity post-closing.

CA-IR-57

**<u>Ref: Application Exhibit 1, Sections 3.18 and 5.9 "Affiliate Contracts."</u>**

Please state the amount of directory publishing advertising revenues that were credited to telephone company income in the most recent Hawaii rate case filing and explain whether or not a comparable amount of directory advertising revenues would be attributed to the regulated telephone operations prospectively under proposed new ownership. Provide complete copies of any studies, reports, affiliate contracts, analyses, workpapers and other documents associated with your response.

CA-IR-58

**<u>Ref: Application Exhibit 1 and Seller's Disclosure, Section 3.24 "Excluded Assets and Services."</u>**

Please provide, for <u>each</u> of the listed "Excluded Assets and Services", the following information:

a. State whether or not the service is required for the conduct of business in Hawaii.

b. Explain how the service is provided currently, indicating each Verizon entity involved.

c. Reference the Schedules within the Transition Services Agreement (Exhibit C) that provide for replacement services during the nine-month term of the TSA.

d. Explain how the Buyer intends to acquire or internally provision the service upon expiration of the TSA.

e. Provide the estimated costs anticipated by the Buyer to provision the service, upon expiration of the TSA, as reflected in each year of the financial projections in Exhibit 6.

f. Provide complete copies of all analyses, studies, projections, bid/proposal materials and other documents associated with your response to part (e).

CA-IR-59

**<u>Ref: Application Exhibit 1, Section 5.5(b) "Financial Statements."</u>**

Please provide complete copies of all quarterly financial statements provided by Seller pursuant to this Section and supplement this response as additional financial statements become available.

CA-IR-60

**<u>Ref: Application Exhibit 1, Section 5.11(b) "Cutover Planning Committee."</u>**

Please identify all Buyer and Seller representatives on the Cutover Planning Committee, provide a listing of all issues identified by the Committee to date, and provide a copy of the most recent compilation of plans prepared to address all such issues.

CA-IR-61

**<u>Ref: Application Exhibit C, Section 4.1(a) "Linked Services Report."</u>**

Please provide a complete copy of all Linked Services Reports, as referenced in this paragraph, and explain how such report(s) were employed to define each of the Transition Services requirements.

CA-IR-62 **<u>Ref: Application Exhibit C, Schedules A and Schedule B.</u>**

Please provide a monthly projection of Buyer's anticipated amounts payable by Schedule as Transition Services for each of the first twelve months from an assumed closing date and explain the cost impacts of the planned cutover and of any unplanned extension of services beyond the term of the Transition Services Agreement, pursuant to paragraph 14.2(b).

CA-IR-63 **<u>Ref: Application Exhibit C, Section 4.2(c) "Cutover Plan."</u>**

Please provide a complete copy of the Cutover Plan referenced in this paragraph.

CA-IR-64 **<u>Ref: Application Exhibit 1, Section 5.12 "Insurance Coverage."</u>**

Please provide, for <u>each</u> of the existing Insurance Contracts listed in Seller's Disclosure Section 3.11, the following information:

a. The approximate annual expense charged to Hawaii operations for the indicated coverage in 2003.

b. A statement of the Buyer's intent to independently secure comparable coverage to be effective upon closing.

c. Descriptions of any coverage to be modified or terminated upon closing and the reasons for such changes.

d. The comparable cost of insurance anticipated by the Buyer, in comparison to the Verizon cost amounts set forth in response to part (a), above.

e. Copies of documentation supportive of your response to part (d).

f. Reference into the financial projections in Exhibit 6, indicating specifically where the costs of insurance are included in the projected operating expenses.

CA-IR-65 **Ref: Application Exhibit 1, Section 5.27 "Prohibited Activities."**

a. Please explain the purpose for the restrictions upon Verizon activities post-closing, indicate the approximate value of these restrictions to the Buyer, if known, and state the basis for the Section 9.10 Allocation of Purchase Price directive to these provisions.

b. In addition, please describe the activities Verizon is expected to continue in Hawaii, if any, subsequent to closing the subject transaction?

CA-IR-66 **Ref: Application Exhibit 1, Paragraph 9.9, Section 338(h)(10) Election for Income Taxes.**

Please explain how income tax expenses and deferred income tax reserves of Verizon Hawaii would be impacted by the proposed acquisition and intended Section 338 election:

a. Any changes in prospective amounts of taxable income.

b. Elimination of existing Verizon Hawaii deferred income tax reserves.

c. Changes in entities that will record deferred income tax reserves.

d. Describe any ratemaking or accounting adjustments proposed by Applicants to address changes described in response to parts a through c, above.

CA-IR-67 **Ref: Application Exhibit 1, Paragraph 10.1(c), "Termination."**

a. Please confirm that the Agreement of Merger is subject to termination due to failure to receive HPUC approval by either May 21, 2005 or the date six months thereafter and explain the basis for the requested expedited regulatory consideration and approval by December 2004 at Application page 2 and footnote 2.

b. Explain and quantify any known "costs" associated with delayed closing after December 2004.

**DOCKET NO. 04-0140**

**PARADISE MERGERSUB, INC., GTE CORPORATION,
VERIZON HAWAII INC., BELL ATLANTIC COMMUNICATIONS, INC.
AND VERIZON SELECT SERVICES INC.
FOR APPROVAL OF A MERGER AND RELATED TRANSACTIONS**

**SECOND SUBMISSION OF INFORMATION REQUESTS**

CA-IR-68

**Ref: Verizon SEC Form 10-Q, First Quarter 2004, page 27.**

According to Verizon's 10-Q report:

> During the first quarter of 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of $43 million ($43 million after-tax, or $.02 per diluted share) included in Income From Other Unconsolidated Businesses in the unaudited condensed consolidated statements of income. The preferred stock was received in 2000 in connection with the sale of access lines in Iowa.

Please provide the following information regarding this event:

a. State whether Verizon accepted this preferred stock as part of the consideration for asset lines sold to Iowa Telecom in 2000.

b. Explain why the ITS preferred stock was made a part of the Iowa access line sales transaction.

c. Explain why no preferred stock consideration was made a part of the proposed sale of Verizon Hawaii.

d. Describe how Verizon determined its original cost basis and calculated the $43 million gain upon disposition.

CA-IR-69 **<u>Ref: Application, Page 12, Part D(1) Financial Fitness.</u>**

In Hawaii PUC Docket No. 95-0051, Verizon (then GTE Hawaiian Tel) submitted testimony by Mr. Michael O'Sullivan (HTC T-4), who sponsored a study (HTC-400) captioned <u>Outside Plant System Loss Estimate Study for</u> Hurricanes in support of his conclusion stated at page 6:

> The analysis determined that a reasonably foreseeable worst-case hurricane event could result in reconstructive costs ranging from $48.6 million if the storm hit Kauai to $461.5 million if it hit Oahu.

Please respond to the following:

a. Please explain the financial capabilities of Verizon to fund storm restoration costs of up to $461 million, in relation to the Corporation's existing lines of credit, liquid assets and other financial resources.

b. Please quantify the financial capabilities of Telco Hawaii to fund storm restoration costs of up to $461 million, under the proposed new ownership and capitalization, in each year of the Exhibit 6 financial projections.

c. Explain how the difference in financial capabilities between parts (a) and (b) of your response should be evaluated by the Commission with respect to whether the proposed transaction is consistent with the public interest.

**The following information requests refer to the Financial Model Projections - General:**

CA-IR-70

a. Have any Verizon Hawaii employees or any of Verizon's financial advisors in the subject transaction reviewed the financial projection model underlying Exhibit 6 for any purpose?

b. If affirmative, please state the scope and purpose of such review and provide complete copies of all correspondence, memoranda, reports, electronic files and other documentation associated with such review.

CA-IR-71

a. Did Verizon provide any forecasted financial information associated with the Hawaii business or assets to prospective Buyer's generally, or Carlyle in particular?

b. If affirmative, provide complete copies of all such information or reference the specific IR responses where such information has been provided.

CA-IR-72

**Ref: Application, Exhibit 6.**

The Applicants' financial projections do not contain a detailed income statement for the regulated Hawaii Telco business. Please provide the Applicants' projected financial results for **each** projected year for the Telco Hawaii local exchange carrier business in the format used to report "Results of Operations" in the Verizon Hawaii Inc. column (see page 1 of HPUC Reports) to the HPUC on a quarterly basis. Please provide your response in spreadsheet format, comparing projected values to calendar year 2002 and 2003 results reported to the HPUC, with explanations of significant differences between 2003 actual results and projected revenue and expense levels, if any.

CA-IR-73

**Ref: Verizon "Results of Operations" reports to HPUC.**

For each of the last two years of reported "GTE Hawaiian Telephone Co Inc." results in the first column of the Results of Operations report to the Hawaii PUC, please identify, explain and quantify any significant normalization adjustments required to make the reported results (inclusive of nonregulated, interstate and intrastate) representative of normal, ongoing conditions. This information is intended to be used in evaluation of your response to the immediately preceding question.

**The following information requests refer to the Financial Model Revenue Projections:**

CA-IR-74 **Ref: Application, Exhibit 6, Description Of Schedules, Page 2 Access Lines.**

The Applicants have included residential access line reductions at a compound average growth rate of negative 1.3% for the years 2004 through 2009, shifting to a positive growth rate of 0.7% thereafter (through 2014). Please provide the following information:

a. Provide Verizon Hawaii's (residential primary, residential secondary, business, other described) actual access line statistics for each quarter of 2003 and 2004 to-date.

b. Verizon's most detailed projections of Hawaii access lines, as well as reflected in the Company's long term business plans and capital projections submitted to the PUC.

c. State the assumptions associated with Applicant's access line growth trend projections, indicating each of the factors contributing to near-term loss rates and longer term growth rates.

d. Provide complete copies of all studies, reports, analyses, workpapers and other documents relied upon in projecting the access line trends included in Exhibit 6.

CA-IR-75 **Ref: Application, Exhibit 6.**

Please provide Verizon Hawaii's actual quarterly access line statistics/data for 2003 and 2004 to-date, in the format included at rows 267, 274, 282, 289 and 296 of the Buildup sheet used for the financial projections, explaining any significant deviation between the values underlying the Exhibit 6 model and the comparable actual data.

CA-IR-76 **Ref: Application, Exhibit 6, Description Of Schedules, Page 2 Access Lines.**

The Average Revenue Per Unit ("ARPU") values in Applicant's projections are said to be, "... based on historical revenue by product and operating metrics, such as access lines or customers." Please provide complete copies of the studies, reports, analyses, workpapers and other documents used to determine the ARPU values used in the projections.

CA-IR-77 **<u>Ref: Application, Exhibit 6.</u>**

a. Please provide a mapping of Verizon Hawaii actual recorded revenue by product for each quarter of 2003 and 2004 to-date, indicating in which rows of the financial model "buildup" sheet were each category of product included (for example, Basic Local Residential @row 427, Local Package Residential @row 432, Interstate Access @row 627, Intrastate Access @row 629, etc.).

b. Explain any adjustments made to the recorded revenues to tie totals into the financial forecast for each quarter of 2003.

c. In addition, provide a reconciliation of total actual revenues to the amount reported to the HPUC for the year 2003.

CA-IR-78 **<u>Ref: Application, Exhibit 6.</u>**

Please provide supporting calculations for the actual and projected interstate and intrastate access average revenue per MOU reflected in the Applicants' projections and explain

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Protective Order No. 21034 .

any ordered or anticipated changes in Interstate or Intrastate access tariffs in relation to such Average Revenue Per Unit ("ARPU") values.

CA-IR-79

**<u>Ref: Application, Exhibit 6.</u>**

Please provide historical actual Verizon Hawaii long distance customer/revenue data in the following categories for **<u>each</u>** quarter of 2001, 2002, 2003 and 2004 to-date, calculated on a basis consistent with the financial projections (buildup rows):

a. Number of residence long distance customers (lines).

b. Number of business long distance customers (lines).

c. Residential LD revenue.

d. Business LD revenue.

CA-IR-80

**<u>Ref: Application, Exhibit 6.</u>**

Please explain the basis for the apparent assumption in the financial projections that Carlyle can [redacted] (buildup rows 849, 854 and 872) in spite of [redacted]

[redacted]. Provide copies of documentation associated with your response.

CA-IR-81 **Ref: Application, Exhibit 6.**

Please provide historical Verizon Hawaii interstate and intrastate access minutes of use statistical data on a quarterly basis for the years 2002, 2003 and to-date 2004 and explain how such data can be reconciled to the projected MOU trends within the financial model (buildup rows 606 and 608).

CA-IR-82 **Ref: Application, Exhibit 6, Description Of Schedules, page 3.**

a. Please provide copies of all available support for the assumption that Carlyle can grow the average revenue per unit associated with large "enterprise" customers by 2 percent per year (buildup row 1991), indicating the specific strategies planned to accomplish this growth.

b. What has been Verizon Hawaii's historical Average Revenue Per Unit ("ARPU") associated with service to Enterprise customers in the years 2001, 2002 and 2003?

CA-IR-83 **<u>Ref: Application, Exhibit 6, Description Of Schedules, page 3.</u>**

a. Please provide copies of all available support for the apparent assumption that Carlyle can grow the average revenue per unit associated with "Special Access" by 2 percent per year (buildup row 2043), indicating the specific strategies planned to accomplish this growth.

b. What has been Verizon Hawaii's historical Average Revenue Per Unit ("ARPU") associated with special access customers in the years 2001, 2002 and 2003?

CA-IR-84 **<u>Ref: Application, Exhibit 6.</u>**

Please explain the derivation of "SAB 101 Revenues" within the model underlying Exhibit 6, at row 538 of the buildup sheet and provide historical data illustrative of Verizon actual comparable experience in each quarter of 2003 and 2004 to-date.

**The following information requests refer to the Financial Model Expense Projections:**

CA-IR-85 **<u>Ref: Application, Exhibit 6, Description Of Schedules, page 3, Operating Expenses.</u>**

a. Please provide copies of all available support for the apparent assumption that Carlyle can constrain the future growth in "headcount expense" to only "1% to 2% percent through the projection period", indicating the specific strategies planned to accomplish this cost constraint in spite of persistently increasing employee medical and retirement cost trends in recent years.

b. What has been Verizon Hawaii's historical rate of cost growth associated with wage rates and employee benefit cost loadings in the years 2002, 2003 and 2004, to date?

CA-IR-86 **Ref: Application, Exhibit 6, Description Of Schedules, page 3, Operating Expenses.**

a. Please provide copies of all available support for the apparent assumption that Carlyle can constrain the future growth in "non-headcount related expenses" of the business to only "1% to 2% percent through the projection period", indicating the specific strategies planned to accomplish this cost constraint.

b. What has been Verizon Hawaii's historical rate of cost growth associated with comparable actual miscellaneous non-wage expenses in the years 2002, 2003 and 2004, to date?

CA-IR-87 **Ref: Application, Exhibit 6.**

a. Please confirm that the "Projected Income Statement" on Schedule 2 does not reflect depreciation and amortization expense based upon the Hawaii PUC-approved accrual rates or FCC-approved accrual rates.

b. In addition, please provide a calculation of Schedule 2, after revising Line 12 "total depreciation and amortization" row of Schedule 2 based upon the Hawaii PUC-approved accrual rates.

CA-IR-88 **Ref: Application, Exhibit 6, Description Of Schedules, page 4, Other.**

Please provide the following information regarding the statement:

> The tax benefit from the amortization of the asset basis is approximately $81 million per year (based on straight line amortization over 15 years), which results in no cash taxes paid throughout the projection period.

a. Explain whether the Section 338(h)(10) election will actually result in a straight line amortization benefit, rather than a basis adjustment subject to Federal IRC rules regarding accelerated depreciation.

b. Provide a schedule of the anticipated tax depreciation impacts of the "tax benefit" that is expected to actually be realizable in each year of the financial projections.

c. State whether the additional tax depreciation associated with the Section 338(h)(10) election is restricted with regard to regulatory flow-through treatment in a manner comparable to other accelerated tax depreciation timing differences.

d. Provide a calculation of the expected current and deferred income tax expenses in each projection year, assuming full tax normalization accounting for the Section 338(h)(10) tax benefit, as well as the proposed accounting for Net Operating Loss carryforward and carryback provisions.

e. State whether any Hawaii taxes historically paid by Verizon will be impacted by the proposed change in ownership and tax elections.

f. Provide an estimate of the state tax expense and payment impacts in each projection year.

CA-IR-89 **<u>Ref: Application, Exhibit 6, Description Of Schedules, page 4, Other.</u>**

a. Regarding the statement:

> The tax benefit from the amortization of the asset basis is approximately $81 million per year (based on straight line amortization over 15 years), which results in no cash taxes paid throughout the projection period.

Please explain whether the regulated telephone business will record and pay income taxes to the parent on a stand-alone basis under the planned intercompany tax allocation agreement or policy.

b. If yes, provide a calculation of regulated telephone company income tax expenses for each year of the projection period.

CA-IR-90 **<u>Ref: Application, Exhibit 6, Description Of Schedules, Page 3 Non-operating Fees of $1 million to Carlyle.</u>**

Please explain the proposed new fees to Carlyle by providing the following information:

a. State whether the fees are estimates of cost-based service charges that would comply with FCC rules regarding affiliated interest charges.

b. Provide a calculation of the estimated fees, indicating each component part of such charges.

c. Explain what business needs are to be met by the fee to Carlyle and quantify the value of services to Hawaii Telco, to the extent possible.

d. Explain whether the fees would be charged above-the-line or below-the-line for purposes of determining operating income reported to the Hawaii PUC.

**The following information requests refer to the Financial Model Balance Sheet Projections:**

CA-IR-91 **<u>Ref: Application, Exhibit 6, Description Of Schedules, page 4, Noncurrent Assets.</u>**

Regarding the statement, "Goodwill of $924 million is not amortized for GAAP purposes," please provide the following information:

a. Explain whether this statement and the Applicants' projections assume that the recorded "goodwill" amounts do not become impaired pursuant to GAAP during the projection period.

b. State whether or not any impairment testing has been conducted to evaluate the potential for valuation adjustments charging off goodwill.

c. Please describe Carlyle's expectations regarding the future risk of any impairment adjustments resulting in charges to income and retained earnings of the Buyer.

d. Explain whether any financing covenants could be impacted by potential future impairment adjustments to recorded goodwill balances.

CA-IR-92 **<u>Ref: Application, Exhibit 6, page 4.</u>**

Please explain why the $924 million of "Goodwill" at row 27, which is larger in each projected year than the entire investment in "Net regulated telephone plant" on row 19, is thought to <u>not</u> be exposed to future impairment adjustment, given the existence of cost-based regulation in Hawaii, where regulated telephone assets cannot be expected to earn returns above the underlying cost of capital for sustained periods.

CA-IR-93 **<u>Ref: Application, Exhibit 6, page 3.</u>**

Please provide a reconciliation of the Row 38 "Capital Expenditures" amounts to the most recent estimate of capital expenditures filed by Verizon Hawaii with the Hawaii PUC, explaining the causes of each significant variance between reported versus projected amounts in Exhibit 6.

CA-IR-94 **<u>Ref: Application, Exhibit 6, page 3.</u>**

Please provide an itemized calculation of the initial balance of "Unamortized Debt Issuance Costs" at row 23 and explain the basis for the apparent 7-year amortization of same.

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S FIRST AND SECOND SUBMISSION OF INFORMATION REQUESTS** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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| GTE Corporation, Verizon Hawaii Inc.,<br>Bell Atlantic Communications, Inc., and<br>Verizon Select Services Inc.<br>c/o Leslie Alan Ueoka, Esq.<br>Blane T. Yokota, Esq.<br>Verizon Corporate Services Group Inc.<br>P.O. Box 2200<br>Honolulu, HI 96841 | 1 copy |
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DATED: Honolulu, Hawaii, August 26, 2004.

Ann Yamamura
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